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Report on Contract Delivery Service Cost Attribution
Accrued Cost and Distribution Key

Introduction:

Contract Delivery Services (CDS) suppliers are independent contractors who provide delivery on specific routes not serviced by city or rural carriers. In response to the USPS Office of Inspector General (OIG) Audit Report Number 20-313-R21, the Postal Service initiated research on the estimation of accrued costs and product costs of CDS. Specifically, the OIG report recommended that the Postal Service undertake two tasks:

1. *Reevaluate the cost proportion percentages used to estimate accrued CDS costs; assess the possibility of using actual CDS payment data to calculate product costs; and, if deemed appropriate, submit a proposal to the PRC to update the costing methodology.*

2. *Conduct a study to determine whether similar mail volumes are delivered on CDS and rural routes; and, based on the results of that study, submit a proposal to the PRC to update distribution keys used to attribute CDS costs, if deemed appropriate.*[1]

The following report provides background into the current methodology for CDS costs and discusses the findings of the investigation into these two areas of study.

Background:

The current treatment of CDS costs can be divided into three steps: 1) the identification of accrued costs; 2) the attribution of costs; and 3) the distribution of costs.

In the general ledger, CDS accrued costs are not separately identified. Instead, CDS accrued costs are included as a portion of different general ledger expense accounts

[1] *See* Contract Delivery Service Cost Attribution (Report Number 20-313-R21, dated June 21, 2021) at 8.

contained in cost segment 14 (purchased transportation), components 143 (Highway) and 145 (Domestic Water). Primarily, these costs are reported in GL Account No. 53605 – Intra-CSD Regular (Intra-District) – and, to a lesser extent, Account No. 53601 – Intra-P&DC Regular. Costs in these two accounts comprise the overwhelming majority of all CDS costs and have a distinct treatment. To the extent that any CDS costs are accrued in other accounts, such as Inter-SCF and Domestic Inland Water, they are treated in the same manner as the non-CDS costs in those accounts.

The current calculation of volume variable CDS Intra-SCF costs relies upon two econometric analyses that were approved by the Commission in Dockets Nos. RM2016-12 (Proposal Four) and RM2021-1 (Proposal Seven). The CDS volume variability, like other highway variabilities, is calculated in a two-step process: 1) the development of a cost-to-capacity variability, and 2) the development of a capacity-to-volume variability. The resulting variabilities are then multiplied together to produce the overall volume variability for the relevant contract costs. The aforementioned dockets presented updates to the capacity-to-volume and cost-to-capacity variabilities, respectively.

The cost-to-capacity volume variabilities for the Intra-District and the Intra-P&DC accounts are individually estimated as the cost-weighted averages of the volume variabilities for four transportation/route types - box, city, van, and Tractor Trailer (TT). The fixed cost weighting proportions applied to the variabilities were last approved in Docket Nos RM2014-6 (Proposal Six) and RM2021-1 (Proposal Seven). This report will investigate whether the accrued costs for CDS box routes could be more precisely

estimated using an alternative data source. This report will also re-estimate the cost-weighting for the transportation types, which in turn would recalculate the variabilities.

The model specifications for the box route equations are presented below. In the equation, *Boxes* stands for the number of curbside boxes, *RL* stands for route length, the "j" indexes individual contract cost segments, the "bar" notation indicates a mean value, the "D_i" are categorical variables, one for each area, ν is a stochastic error term, and the β and δ coefficients are parameters to be estimated.

$$\ln Cost_j = \beta_0 + \sum_{i=1}^{n} \delta_i D_i + \beta_1 ln\left(\frac{Boxes_j}{\overline{Boxes}}\right) + \beta_2 ln\left(\frac{Boxes_j}{\overline{Boxes}}\right)^2 + \beta_3 ln\left(\frac{RL_j}{\overline{RL}}\right) + \beta_4 ln\left(\frac{RL_j}{\overline{RL}}\right)^2 + \beta_5 ln\left(\frac{Boxes_j}{\overline{Boxes}}\right) ln\left(\frac{RL_j}{\overline{RL}}\right) + \nu_j$$

The distribution of the variable CDS costs in Intra-SCF accounts have been based on the Intra-SCF distribution factors estimated by the Transportation Cost System (TRACS) on a quarterly basis since it was first introduced.[2] CDS routes are not sampled in TRACS and therefore have utilized the Intra-SCF distribution factors as a reasonable proxy.

[2] The introduction of TRACS was discussed in the Opinion and Recommended Decision, Docket Number R90-1, January 4, 1991, Vol. I at III-154 - 164.

Analysis of OIG Recommendation One

This portion of the report analyzes the OIG's first recommendation:

> We recommend the Vice President, Pricing and Costing, reevaluate the cost proportion percentages used to estimate accrued contract delivery service (CDS) costs; assess the feasibility of using actual CDS payment data to calculate volume variable costs; and, if deemed appropriate, submit a proposal to the Postal Regulatory Commission to update the costing methodology.

Historical Calculation of Intra-P&DC and Intra-District Cost Proportions:

The current methodologies for calculating the Intra-P&DC and Intra-District cost proportions were approved by the Commission in Docket No. RM2021-1 (Proposal Seven), Order No. 5999, October 6, 2021, and Docket No. RM2014-6 (Proposal Six), Order No. 2180, September 10, 2014, respectively. The cost proportions, used in the calculation of purchased highway transportation cost-to-capacity variabilities, were developed using FY 2013 (Intra-District) and FY 2019 (Intra-P&DC) data from the Transportation Contract Support System (TCSS).

The Intra-P&DC and Intra-District account categories are made up of multiple transportation technologies and route types. Changes in either the individual variabilities for the transportation/route types or their relative proportions of the account category's costs can change the overall account category variability.[3] Both account categories consist of the following four transportation/route types: box, city, van, and TT. The unit of analysis is contract cost segments,[4] which are apportioned to each grouping using

[3] *See* USPS-RM2014-6/1, Rpt.Updat.PHT.Cost.Cap.Variab.docx at 29.
[4] *Id* at 7-8.

the route type, number of boxes, vehicle capacity, and route number.[5] Within each route/transportation type, the costs are summed to form the account category's cost proportions.

Reevaluate the Cost Proportions Used to Estimate Accrued Contract Delivery Service (CDS) Costs:

The Postal Service has reevaluated the cost proportions using updated TCSS and Accounts Payable Excellence System (APEX) datasets. First, the cost proportions were recalculated using FY 2020 and FY 2021 TCSS data. The results are presented in Table 1. In the period between FY 2013 and FY 2021, several shifts in the cost proportions have occurred. In the Intra-P&DC account category, the percentage decreased for van routes and increased for TT routes, with smaller percentage increases occurring in box routes and city routes. These changes were largely captured by the update to the Intra-P&DC cost proportions in Docket No. RM2021-1. In the Intra-District account category, which has not received updated cost proportions since Docket No. RM2014-6, the percentages decreased for box routes and (to a lesser degree) city routes, while increasing significantly for TT routes and less so for van routes.

[5] *See* USPS-RM2014-6/1, Tech.Append.Hwy.Variab.Updat.docx, at 70-72. and USPS-RM2021-1-1, *INTRA PDC Variability Equations.sas.*

Table 1: Intra-PDC and Intra-District Cost Proportions using TCSS Data

Type	FY 2013	FY 2019	FY 2020	FY 2021
INTRA-PDC				
Box Route	1.1%	**1.6%**	1.6%	1.6%
City Route	8.6%	**8.8%**	9.2%	9.1%
Van	58.9%	**51.8%**	52.0%	51.2%
Tractor Trailer	31.5%	**37.8%**	37.2%	38.1%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**
INTRA-DISTRICT				
Box Route	**80.5%**	75.5%	75.1%	76.0%
City Route	**3.3%**	1.8%	1.7%	1.7%
Van	**14.4%**	14.9%	15.4%	15.3%
Tractor Trailer	**1.9%**	7.7%	7.8%	7.0%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: OIG_CDS_response_tables.xlsx
Note: Current approved percentages in bold.

The Postal Service has calculated the updated cost proportions using the Docket No. RM2021-1 methodology. This methodology was used for both the Intra-P&DC and Intra-District cost proportions and differs only slightly from the methodology used in Docket No. RM2014-6 where additional data cleaning was performed.[6]

The Postal Service also has assessed the feasibility of using CDS payment data from APEX to form the cost proportions for the Intra-P&DC and Intra-District account categories. APEX data do not contain the information necessary to apportion payments between all four transportation/route types, namely information on the vehicle capacity, which was a limitation recognized by the OIG that remains in place.[7] The cost

[6] *See* USPS RM2021-1-1, *INTRA PDC Variability Equations.sas.*
[7] *See Contract Delivery Service Cost Attribution* (Report Number 20-313-R21, dated June 21, 2021) at 8.

proportions that can be calculated for box routes have been updated for FY 2021. The resulting cost proportions are 1.9 percent in the Intra-P&DC account category and 76.5 percent in the Intra-District account category.[8]

Assess the Feasibility of Using Actual CDS Payment Data to Calculate Volume Variable Costs:

While the cost proportions cannot be calculated using APEX data, the OIG also inquired about the feasibility of using the data to estimate accrued and volume variable CDS costs. This methodology would serve as an alternative to the estimation method used by the Postal Service. Previously, the Postal Service compared the FY 2019 TCSS and APEX box/combination route costs and found significant discrepancies. Ultimately, the Postal Service determined that the APEX data did not "improve the quality, accuracy, or completeness of the data or analysis of data", which is the Commission evaluation standard.[9]

An updated comparison of the box/combination route costs across the two datasets is provided in Table 2 below. As opposed to the FY 2019 comparison, the APEX data now include combination routes. The inclusion of combination routes significantly reduces the overall discrepancy between the costs in the two datasets. However, as illustrated by Table 2, there remain material differences across the two datasets when attempting to measure CDS costs. The FY 2021 APEX data cannot be used to fully isolate CDS costs from all box and combination route costs, because doing so requires vehicle

[8] *See* Table 4 of OIG_CDS_response_tables.xlsx
[9] *See 39 C.F.R. § 3050.11(a).*

capacity data. Therefore, an estimate of accrued and volume variable CDS costs using APEX data would also include costs associated with other transportation/route types.

Table 2: FY 2021 TCSS and APEX Box and Combination Route Cost Comparison (Costs in Thousands)

GL Account	APEX - All Box/Combo. Routes	TCSS- All Box/Combo. Routes	TCSS - CDS Only	Difference	% Difference
	[1]	[2]	[3]	[1] - [3]	
53138	0		-	0	
53183	225	299	299	(74)	-24.8%
53601	19,063	19,508	16,412	2,651	16.1%
53604	3		-	3	
53605	429,843	430,229	423,901	5,941	1.4%
53606	130	128	128	1	1.0%
53609	1,070	945	487	583	119.7%
53614	1,379	1,363	844	534	63.3%
53618	2,046	1,992	1,992	54	2.7%
53625	13	13	-	13	
53905	(27)	-	-	(27)	
TOTAL	**453,744**	**454,478**	**444,065**	**9,679**	**2.2%**

Source: OIG_CDS_response_tables.xlsx

An additional comparison is provided in Table 3 below. Table 3 mirrors the analysis conducted by the OIG in comparing CDS accrued, volume variable, and institutional

costs under multiple methods.[10] However, Table 3 shows updated values for FY 2021 and additionally provides calculations using FY 2021 TCSS cost proportions from Table 1.

Table 3: FY 2021 CDS Cost Estimates

Costs ($000s)	USPS - Current Proportions	USPS - New Proportions	OIG - APEX Data
Accrued	$471,459	$446,708	$448,906
VV & PS	$111,802	$105,861	$106,237
Institutional	$359,656	$340,847	$342,669

Source: OIG_CDS_response_tables.xlsx

Table 3 shows that the cost estimates decreased substantially when the FY 2021 TCSS cost proportions were substituted for the current cost proportions. This decrease was caused by the fact that the updated cost proportions for CDS costs, particularly within the Intra-District account category, were much closer in value to the proportions calculated using APEX data.

As previously mentioned, Intra-P&DC cost proportions were updated in Docket No. RM2021-1. Due to this update, the cost impact of applying the FY 2021 TCSS proportions is slightly blunted, as most of the impact is related to the updated

[10] *See* Table 3 of *Contract Delivery Service Cost Attribution* (Report Number 20-313-R21, dated June 21, 2021) at 8.

proportions for Intra-District. As a result of this recommendation, highway costs would increase by 0.03 percent during the initial update.[11]

Conclusion on Recommendation One:

The Postal Service has reevaluated the cost proportions used to estimate accrued contract delivery service (CDS) costs and assessed the feasibility of using actual CDS payment data to calculate volume variable costs. The Postal Service recognizes the shift in the cost proportions that have occurred in the period since Docket No. RM2014-6, as well as the significantly smaller shift occurring since Docket No. RM2021-1 and between consecutive fiscal years. Thus, for the portion of Proposal Five that relates to OIG Recommendation One, the Postal Service proposes to update the Intra-P&DC and Intra-District cost proportions annually using TCSS data and the method explained above. This approach is not possible using APEX data, given its current limitations.

The Postal Service also does not believe the use of APEX data would represent an improvement over the use of annually updated TCSS cost proportions for the estimation of volume variable CDS costs. An annual update of the TCSS cost proportions will significantly reduce the discrepancy between the Postal Service's method for calculating accrued and volume variable CDS costs and the OIG's method for calculating these same costs, as the TCSS data have captured shifts in Intra-SCF costs similar in magnitude and in the same direction as the APEX data. Furthermore, while box and

[11] *See* CDS Proposal - Public Impact Rec 1.xlsx

combination routes can be isolated in the APEX data, no further distinction between CDS and non-CDS costs is available.

Analysis of OIG Recommendation Two:

This portion of the report analyzes the OIG's second recommendation:

> We recommend the Vice President, Pricing and Costing, conduct a study to determine whether similar mail volumes are delivered on contract delivery service (CDS) and rural routes; and, based on the results of that study, submit a proposal to the Postal Regulatory Commission to update distribution keys used to attribute CDS costs, if deemed appropriate.

Historical Distribution of CDS Costs:

The current methodology for calculating the distribution keys for CDS costs was approved by the Commission in Docket No. R90-1, which first introduced the Transportation Cost System (TRACS), on January 4, 1991. Since then, the TRACS Intra-SCF distribution factors have remained the established method to distribute volume variable CDS costs to postal products.

Investigation Findings:

In order to investigate whether a more appropriate distribution key could be applied to CDS costs, the Postal Service first conducted a literature review of available CDS related materials. Based on this information, the Postal Service developed questions which were posited to internal stakeholders, such as those responsible for Highway Contracting and the administration of CDS routes. During the course of this investigation, it became apparent that both operational protocols and field observations support the hypothesis that similar mail volumes are delivered on CDS routes and rural routes.

The majority of CDS routes are box routes, which are focused on delivery, while the less frequent combination routes consist of both delivery and highway transportation activities. A comparison of documented duties confirmed that similar activities are performed by CDS contractors and rural carriers. Table 4 compares the activities of CDS suppliers, rural carriers, and Intra-SCF contractors, and demonstrates the similarities in activities between CDS suppliers and rural carriers and the differences from those performed by Intra-SCF contractors.

Table 4: Activities of CDS Suppliers, Rural Carriers, and Intra-SCF Contractors[12]

Activities	CDS Suppliers	Rural Carriers	Intra-SCF Contractors
Case Mail	✓	✓	×
Deliver Mail	✓	✓	×
Collect Mail	✓	✓	×
Sell stamps	✓	✓	×
Collect postage dues	✓	✓	×
Perform mail markups	✓	✓	×
Collect on delivery	✓	✓	×
Making merchandise returns	✓	✓	×
Perform mail forwarding	✓	✓	×
Selling money orders	✓	✓	×
Transport mail between SCFs and post offices	×	×	✓

[12] *See Contract Delivery Service Cost Attribution* (Report Number 20-313-R21, dated June 21, 2021) Table 4 at 11.

Further support for the similarities between CDS contractors and rural carriers is found in the process that exists for the conversion of CDS routes to rural routes in comparable offices. For comparable routes, cost comparisons can be conducted between CDS and rural routes based on a standardized form.[13]

In order for routes to be comparable:

- The CDS contract route must be in an office which only contains CDS and rural routes.
- A rural carrier must be capable of executing all activities of the CDS route.

If a CDS route is eligible and the data indicate that it is advantageous from a financial or service perspective to the Postal Service for these deliveries to be conducted by a rural carrier, the route may be converted from a CDS route to a rural route. This feature indicates that CDS routes may have similar volumes to rural routes because some rural deliveries were previously conducted by CDS contractors before conversion. These routes would have the potential to be sampled in the Rural Carrier Cost System (RCCS) after conversion were to take place. While conversions are not uncommon, and the Postal Service does collect data on which CDS routes were converted to rural, it is difficult to map a converted CDS route to a rural route. The difficulty lies with how the CDS route is incorporated into the rural framework. The decisions of how to incorporate the boxes served is a local decision and may vary widely depending on local staffing and union agreements; for example, the CDS route may be parsed into geographical

[13] *See Management of Rural Delivery Services and Handbook EL-902, Agreement between USPS and National Association of Rural Letter Carriers, Article 32, Subcontracting*.

segments and added on to one or more established rural routes, an auxiliary route may be established or amended, or a new rural route may be established. CDS routes can be converted quite seamlessly to minimize the impact on operations, and identifying the original CDS route which may be fragmented afterwards presents a difficulty. In contrast, rural routes are typically not converted to CDS routes due to previous agreements.

In order to further understand the operational reality of CDS activities, a site visit to the Locust Grove, VA post office was conducted. Though this office contained only CDS contractors, and thus would not be eligible for conversion to rural routes, it is important to verify that operations are consistent despite non-eligibility. Overall, it was observed that activities and mail volumes seemed consistent with any rural office. The observed activities performed by CDS contractors supported the conclusion that the application of the rural key would be a more appropriate distribution for CDS costs. Further discussions with the Postmaster also supported this conclusion. Currently, the applied distribution does not attribute any costs to DDU drop-shipped mail for CDS routes, nor does it account for any ancillary or special services (e.g., Certified Mail). The application of the rural distribution key instead would address some of these weaknesses.

The Postal Service was also able to recreate the OIG analysis of the impact of WebEOR and PTR mail mixes on rural and CDS routes, observing that they are similar in this case.[14] However, since this limited analysis only compared route volumes within

[14] *See Contract Delivery Service Cost Attribution* (Report Number 20-313-R21, dated June 21, 2021) Table 5 at 12.

the same offices and not in the system overall, there are limitations in projecting interpretations to the entire Postal delivery system. Nonetheless, the investigation does indicate that the application of the rural distribution key to CDS volume variable costs would improve the accuracy and reliability of the product cost estimates.

Impact of Rural Distribution Key

In order to apply the rural cost distribution key (CS10, component 260) to CDS costs and the appropriate volume variability to the remainder of the Intra-SCF accounts, the established proportions would first be applied to the major CDS cost accounts in order to isolate an estimate of costs. The appropriate volume variabilities would then be applied. Generally, the volume variability in highway transportation is comprised of the product of the cost-to-capacity and the capacity-to-volume variabilities. However, for box routes, only the cost-to-capacity variability calculated in Docket Nos RM2021-1 and RM2014-6 would be applied to the estimated accrued costs. The capacity-to-volume variability would no longer be applicable in this case. CDS volume is not recorded in TRACS and the capacity-to-volume variability for these accounts, as approved, is not related to CDS route volume. Furthermore, the capacity-to-volume variability for transportation measures the change in capacity (cubic-foot miles = truck size * trip frequency) due to changes in volume. Since CDS contracts specify service to a set of delivery points, it is unlikely that reasonable changes in volume would lead to a change in the number of boxes served on a route. Thus, the underling motivation for the volume-to-capacity variability does not hold for CDS routes. Table 5 depicts the current and proposed variabilities for the Intra-P&DC and Intra-District regular accounts under Recommendation Two. To be able to apply the separate distribution keys, these

accounts would be broken out into the estimated CDS costs and the remaining Intra-SCF costs.

Table 5: Intra-SCF Account Variabilities - Recommendation 2

Account Category	Cost to Capacity Variability	Capacity to Volume Variability	Overall Volume Variability
Current Intra P&DC	81.6%	77.3%	63.0%
Proposed CDS	24.2%	-	24.2%
Proposed Account Remainder	82.5%	77.3%	63.7%
Current Intra District	38.1%	77.3%	29.4%
Proposed CDS	31.0%	-	31.0%
Proposed Account Remainder	67.1%	77.3%	51.9%

Source: CDS Proposal - Calculation of Variability.xlsx

Due to the above changes in variability, volume variable highway costs are estimated to increase by $33.7 M, or 0.9 percent.[15] After multiplying the appropriate variability in this case, the rural carrier distribution key would be used to attribute the costs to postal products. Based on this distribution key, Total Domestic Market Dominant Services would be attributed 0.2 percent of the volume variable costs for highway transportation. Currently, the fact that CDS contractors handle special service activities is not accounted for in the Intra-SCF distribution key. With the application of the rural distribution key, highway costs for High Density and Saturation Flats/Parcels and In County Periodicals increased significantly. This increase, however, results in less than a $0.01 increase on a unit cost basis. Table 6 shows the difference in unit highway

[15] See *CDS Proposal - Public Impact Rec 2.xlsx*

purchased transportation costs, using both the portion of Proposal Five relating to OIG Recommendation Two and the established methodology.[16]

Table 6: Highway Unit Cost Impact - Recommendation Two Portion

PRODUCT	Proposed Highway Unit Cost	Current Highway Unit Cost	Highway Unit Cost Difference
Single-Piece Letters	$ 0.021	$ 0.021	$ (0.000)
Single-Piece Cards	$ 0.010	$ 0.010	$ 0.000
Presort Letters	$ 0.009	$ 0.009	$ 0.000
Presort Cards	$ 0.007	$ 0.006	$ 0.000
Single-Piece Flats	$ 0.217	$ 0.222	$ (0.006)
Presort Flats	$ 0.077	$ 0.077	$ (0.001)
Total First-Class Mail	**$ 0.015**	**$ 0.015**	**$ (0.000)**
High Density and Saturation Letters	$ 0.001	$ 0.001	$ 0.001
High Density and Saturation Flats/Parcels	$ 0.003	$ 0.001	$ 0.002
Every Door Direct Mail-Retail	$ 0.000	$ -	$ 0.000
Carrier Route	$ 0.011	$ 0.009	$ 0.001
Letters	$ 0.005	$ 0.005	$ 0.000
Flats	$ 0.051	$ 0.051	$ (0.000)
Parcels	$ 0.157	$ 0.156	$ 0.001
Total USPS Marketing Mail	**$ 0.007**	**$ 0.006**	**$ 0.001**
In County	$ 0.002	$ 0.000	$ 0.002
Outside County	$ 0.049	$ 0.049	$ 0.000
Total Periodicals	**$ 0.043**	**$ 0.043**	**$ 0.001**
Alaska Bypass Service	$ -	$ -	$ -
Bound Printed Matter Flats	$ 0.052	$ 0.052	$ (0.000)
Bound Printed Matter Parcels	$ 0.092	$ 0.088	$ 0.003
Media/Library Mail	$ 1.038	$ 1.053	$ (0.015)
Total Package Services	**$ 0.274**	**$ 0.275**	**$ (0.002)**
US Postal Service	$ 0.094	$ 0.096	$ (0.002)
Free Mail	$ 0.131	$ 0.132	$ (0.001)
Total Domestic Market Dominant Mail	**$ 0.013**	**$ 0.013**	**$ 0.000**
Certified Mail	$ 0.040	$ -	$ 0.040
COD	$ 0.132	$ -	$ 0.132
Insurance	$ 0.006	$ -	$ 0.006
Registered Mail	$ 0.036	$ -	$ 0.036

[16] The impact of the new variabilities and distribution key on competitive products are presented in the non-public file, CDS Proposal - Non Public Impact - Rec 2.xlsx in USPS-RM2022-11-NP1.

Other Domestic Ancillary Services	$ 0.014	$ -	$ 0.014
Money Orders	$ 0.000	$ -	$ 0.000
Post Office Box Service	$ -	$ -	$ -
Total Domestic Market Dominant Services	$ 0.021	$ -	$ 0.021
Total Domestic Competitive Mail and Services	$ 0.289	$ 0.291	$ (0.002)
Total International Mail and Services	$ 0.196	$ 0.196	$ 0.001

Conclusion on Recommendation Two:

After this investigation, the Postal Service has determined that the mail volume mix between CDS routes and rural routes are likely similar, and that the rural distribution key would serve as a better proxy for CDS distribution than the currently applied TRACS Intra-SCF distribution factors. Therefore, the Postal Service proposes that the rural distribution key be applied to attribute CDS costs. The Postal Service does note that differences still exist in how these costs are accrued for these route types. Typically, rural delivery labor costs are incurred based on a set of collectively bargained evaluation factors. CDS costs are incurred based on negotiated contracts, like other transportation contracts. However, the similarity of activities performed cannot be ignored. This change in distribution keys is supported by operational conduct and would significantly improve the accuracy of product cost estimation for CDS.

Impact of Updated Proportions and Distribution Key – Recommendations One and Two

In order to implement both aspects of Proposal Five – one part relating to OIG Recommendation One and the other relating to OIG Recommendation Two -- the steps described previously with respect to OIG Recommendation Two would be repeated with the exception of utilizing re-estimated TCSS cost proportions and thus re-estimated

cost-to-capacity variabilities on an annual basis. While the variabilities for box routes costs remain the same, applying the proportions from the first part of the Proposal shifts the volume variability for the remaining Intra-SCF costs as shown in Table 7. Since the Intra-P&DC proportions were recently updated, the change in variability is mostly limited to the remaining Intra-District costs.

Table 7: Intra-SCF Account Variabilities - Joint Proposal

Account Category	Cost to Capacity Variability	Capacity to Volume Variability	Overall Volume Variability
Current Intra P&DC	81.6%	77.3%	63.0%
Proposed CDS	24.2%	-	24.2%
Proposed Account Remainder	82.5%	77.3%	63.7%
Current Intra District	38.1%	77.3%	29.4%
Proposed CDS	31.0%	-	31.0%
Proposed Account Remainder	70.6%	77.3%	54.5%

Source: CDS Proposal - Calculation of Variability.xlsx

The implementation of both portions of the proposal using FY 2021 data results in a shift of $42.6M, or 1.2 percent, in highway costs from institutional to volume variable costs.[17] Competitive highway costs decrease by 0.02 percent under this proposal while Market Dominant costs increase by 2.5 percent.[18] Due to the application of the rural distribution key, highway costs for High Density and Saturation Flats/Parcels and In County Periodicals increased significantly on a percentage basis. This increase,

[17] *See* CDS Proposal - Public Impact Joint.xlsx

[18] The impact of the new variabilities and distribution key on competitive products are presented in the non-public file, CDS Proposal - Non Public Impact - Joint.xlsx in USPS-RM2022-11-NP1.

however, results in less than a $0.01 increase on a unit cost basis. Approximately 0.2 percent of the volume variable costs for highway transportation would be attributed to Total Domestic Market Dominant Services under this methodology.